

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SAM-01 AID-05 CIAE-00 COME-00 EB-07

FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

STR-04 CEA-01 L-03 H-02 DODE-00 PA-01 PRS-01 /088 W  
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R 111159Z AUG 76

FM AMEMBASSY LISBON

TO SECSTATE WASHDC 8169

C O N F I D E N T I A L SECTION 1 OF 2 LISBON 5442

E.O. 11652: GDS

TAGS: EFIN, PO

SUBJECT: PORTUGAL'S BALANCE OF PAYMENTS PROSPECTS

REFS: (A) STATE 177290, (B) LISBON 5049

1. SUMMARY: THE EMBASSY HAS PREPARED HIGHLY TENTATIVE PROJECTIONS FOR PORTUGAL'S 1977 BALANCE OF PAYMENTS. THE PRESENT FLUID SITUATION, HOWEVER, MILITATES AGAINST THE PREPARATION OF A SINGLE PROJECTION. WE HAVE, THEREFORE, PREPARED TWO OF THEM. OPTION A, REFLECTING AN AGGRESSIVE GOP DEVELOPMENT PROGRAM, WOULD LIKELY PRODUCE A DEFICIT OF SOME \$500 MILLION. OPTION B, REPRESENTING A CONTINUATION OF GOP'S ECONOMIC INDECISIVENESS, WOULD PROBABLY PRODUCE A DEFICIT APPROXIMATING \$1.6 BILLION. ALTHOUGH THE LATTER OPTION IS CLEARLY UNACCEPTABLE, IT IS POLITICALLY ATTRACTIVE IN THAT IT WOULD PERMIT GOP TO AVOID DIFFICULT SHORT-TERM ISSUES. DECISIONS OVER THE NEXT FEW MONTHS WILL INDICATE WHICH COURSE THE GOP WILL SELECT. END SUMMARY.

2. BANK OF PORTUGAL STILL HAS NOT PROVIDED ITS 1977 BALANCE OF PAYMENTS PROJECTIONS. WE HAVE, THEREFORE, PREPARED OUR OWN HIGHLY TENTATIVE PROJECTIONS. SINCE FUTURE GOP DECISIONS WILL HAVE DETERMINANT INFLUENCE ON  
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ECONOMIC TRENDS, ONE CANNOT YET PREDICT WITH ANY

CERTAINTY THE LIKELY BALANCE OF PAYMENTS RESULTS FOR 1977. WE ARE, AS A RESULT, PRESENTING HEREIN TWO POSSIBLE ALTERNATIVES. GOP DECISIONS DURING THE NEXT FEW MONTHS WILL DETERMINE WHICH OF THESE ALTERNATIVES MORE ACCURATELY REFLECTS REALITIES.

3. BOTH ALTERNATIVES REST ON THE SAME BASIC UNDERLYING ASSUMPTIONS: 1) PORTUGAL'S MAJOR TRADING PARTNERS WILL INCREASE THEIR EXTERNAL TRADE BY 8 PERCENT IN REAL TERMS; 2) INTERNATIONAL PRICES WILL RISE 10 PERCENT; AND 3) BANK OF NORTUGAL WILL KEEP THE DOMESTIC BANKING SYSTEM RELATIVELY LIQUID. CAPITAL ACCOUNTS PRESENTED IN TABLE OF PARA 7 DO NOT INCLUDE OFFICIAL COMPENSATORY FINANCING.

4. ALTERNATIVE A WOULD RESULT FROM AN AGGRESSIVE GOP POLICY DESIGNED TO MOVE THE ECONOMY BACK TOWARD EQUILIBRIUM WHILE PROMOTING AN ACCELERATED RATE OF DEVELOPMENT. THE ASSUMPTIONS UNDERLYING THIS PROJECTION INCLUDE: 1) ESCUDO DEVALUATION OF APPROXIMATELY 25 PERCENT; 2) ADOPTION OF AN AGGRESSIVE EXPORT DRIVE AND IMPOSITION OF RELATIVELY FEW IMPORT RESTRICTIONS ON THE PRIVATE SECTOR; 3) A SUBSTANTIAL INCREASE IN DOMESTIC INTEREST RATES; 4) RESTORATION OF LABOR PRODUCTIVITY; 5) CONTINUED RAPID PROGRESS TOWARD POLITICAL STABILITY; 6) FURTHER INCREASE IN PUBLIC SECTOR INVESTMENT; AND 7) GNP GROWTH OF 6 PERCENT. IN THIS ALTERNATIVE, EXPORTS ARE EXPECTED TO EXPAND BY SOME 20 PERCENT, AND IMPORTS BY ONLY 16 PERCENT. THE POSITIVE BALANCE FOR INVISIBLES WOULD RISE SIGNIFICANTLY OVER 1976, LARGELY BECAUSE OF A GROWTH IN TOURISM AND TRANSFER RECEIPTS. ON THE CAPITAL ACCOUNT, THIS ALTERNATIVE FORESEES A REVERSAL SHARP ENOUGH TO PRODUCE A POSITIVE BALANCE. GIVEN APPROPRIATE CONDITIONS, FOREIGN INVESTMENT SHOULD INCREASE AND FOREIGN BANKERS SHOULD AUGMENT THEIR CREDIT LINES. BANK OF PORTUGAL WILL LIKELY ENCOURAGE THIS TREND BY SEVERELY RESTRICTING THE USE OF DOMESTIC CREDITS TO FINANCE IMPORTS. EVEN SO, OVERALL DEFICIT WOULD APPROXIMATE \$500 MILLION.

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5. ALTERNATIVE B WOULD REFLECT A GOP OPTION FOR CONTINUED TEMPORIZING. THIS ALTERNATIVE RESTS UPON THE FOLLOWING ASSUMPTIONS: 1) A MINIMUM DEVALUATION OF THE ESCUDO; 2) ONLY A MODERATE RECOVERY IN PRODUCTIVITY; 3) INCREASINGLY TIGHT IMPORT CONTROLS; 4) LITTLE OR NO INCREASE IN DOMESTIC INTEREST RATES; 5) INTERMITTANT LABOR/POLITICAL DISTURBANCES; 6) SIGNIFICANT PUBLIC SECTOR INVESTMENT; AND 7) A GNP

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R 111159Z AUG 76  
FM AMEMBASSY LISBON  
TO SECSTATE WASHDC 8170

C O N F I D E N T I A L SECTION 2 OF 2 LISBON 5442

INCREASE OF NO MORE THAN 2 PERCENT. UNDER THIS HYPOTHE-  
SIS, EXPORTS WOULD GROW BY ABOUT 14 PERCENT, BUT THE  
INCREASINGLY SEVERE IMPORT RESTRICTIONS WOULD HOLD IMPORT  
GROWTH TO 11 PERCENT, PRODUCING A MERCHANDISE DEFICIT  
OF \$1.8 BILLION. ON THE OTHER HAND, THE INVISIBLE SUR-  
PLUS WOULD BE SMALLER THAN IN ALTERNATIVE A, LARGELY  
BECAUSE OF A SLOWER RECOVERY IN TOURISM AND TRANSFER  
RECEIPTS. MOST IMPORTANT, THE CAPITAL ACCOUNT WOULD  
CONTINUE TO BE HEAVILY IN DEFICIT. AS EXCHANGE RESERVES  
DECLINE, SHORT-TERM CREDITS WOULD UNDOUBTEDLY CONTINUE  
TO DIMINISH, CAPITAL FLIGHT WOULD ACCELERATE SUBSTAN-  
TIALY, AND THE OVERALL DEFICIT UNDER THIS ALTERNATIVE  
WOULD APPROXIMATE \$1.65 BILLION.

7. PORTUGAL'S BALANCE OF PAYMENTS  
(IN MILLIONS OF DOLLARS)

	PROJECTED 1976	A	PROJECTED 1977 B
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I. CURRENT ACCOUNT	-1,065		-1,057 -1,135
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A. MERCHANDISE	-1,727		-1,920 -1,830
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1. EXPORTS (FOB)	1,973		2,370 2,240
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2. IMPORTS (FOB)	-3,700		-4,290 -4,070
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B. INVISIBLES	662		863 695
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1. TOURISM	160		230 180
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2. TRANSPORTATION	-155		-175 -160
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3. INSURANCE	- 5		- 7 - 5
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4. INVESTMENT INCOME	-83		-95 -90
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5. TRANSFERS	925		1,100 950
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6. OTHERS	-180		-190 -180
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II. CAPITAL ACCOUNT	-470		525 -525
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A. SHORT TERM	-230		250 -150
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B. MEDIUM & LONG TERM	-240		275 -375
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1. PRIVATE SECTOR	(-160)		(200) (-225)
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2. PUBLIC SECTOR	( -80)		( 75) (-150)
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III. TOTAL DEFICIT	-1,535		-532 -1,660
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8. ALTERNATIVE B UNDOUBTEDLY WOULD CONSTITUTE A POOR CHOICE FOR GOP ECONOMIC POLICYMAKERS. NEVERTHELESS, SELECTION OF THAT ALTERNATIVE WOULD AVOID THE NEED TO TAKE SHORT-TERM DIFFICULT POLITICAL DECISIONS. THE GOP MAY, THEREFORE, TEND TOWARD ALTERNATIVE B, A TENDENCY ALREADY SUGGESTED BY RECENT ADMINISTRATIVE RESTRICTIONS ON IMPORTS. IN EFFECT, GOP ECONOMIC POLICYMAKERS WILL HAVE TO DISPLAY CONSIDERABLE LEADERSHIP AND COURAGE TO REVERSE THISTREND.

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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** BALANCE OF PAYMENTS, ECONOMIC TRENDS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 11 AUG 1976  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** CunninFX  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1976LISBON05442  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** GS  
**Errors:** N/A  
**Film Number:** D760309-0179  
**From:** LISBON  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1976/newtext/t19760865/aaaaceox.tel  
**Line Count:** 222  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Office:** ACTION EUR  
**Original Classification:** CONFIDENTIAL  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 5  
**Previous Channel Indicators:** n/a  
**Previous Classification:** CONFIDENTIAL  
**Previous Handling Restrictions:** n/a  
**Reference:** 76 STATE 177290, 76 LISBON 5049  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** CunninFX  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 04 MAY 2004  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <04 MAY 2004 by BoyleJA>; APPROVED <01 SEP 2004 by CunninFX>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
04 MAY 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** PORTUGAL'S BALANCE OF PAYMENTS PROSPECTS  
**TAGS:** EFIN, PO  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006